Kingston Smith & Partners

Licensed Insolvency Practitioners

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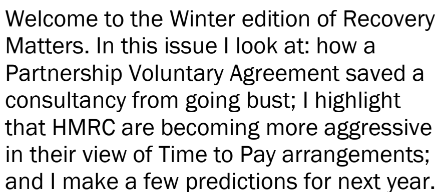

Welcome to the Winter edition of Recovery Matters. In this issue I look at: how a Partnership Voluntary Agreement saved a consultancy from going bust; I highlight that HMRC are becoming more aggressive in their view of Time to Pay arrangements; and I make a few predictions for next year.

\- Ian Robert

In Partnership with HMRC – the tale of a PVA: A case study

In the Summer 2010 edition of Recovery Matters ("Revival or Survival"), I looked at the rise of Company Voluntary Arrangements ("CVAs") as a tool to assist corporate survival, and questioned whether they were always in the interests of the Company and its creditors. If you recall, the CVA allows a Company to contract with its creditors to accept a compromise of its debts, without handing the management of its company over to a licensed insolvency practitioner. Given that the board remain at the helm, this is often seen as a preferred alternative to a formal insolvency appointment.

But what if the business in question is a partnership? Most professional businesses, whether they are lawyers, accountants, consultants etc have converted the partnership to an LLP to take advantage of limited liability partnerships. With advice and careful planning these are often seen as a preferred option to a straightforward partnership. As you will no doubt know, as a partner, you have no protection from liability as you are equally personally liable, jointly and severally, with your other partners for all your partnership debts.

The case details:

A 4 partner engineering consultancy had built up substantial debts, mainly to the Crown for VAT and PAYE, as a result of a failed sister operation in New York.

Substantial funds had been channelled over to New York to get that business off the ground, but its ability to repay those sums had been far slower than expected, resulting a large debt from the US business to the partnership, starving the UK business of cash to pay its creditors.

As a consultancy business, its major cost was payroll, and thus the Crown had not been paid the sums due. The partners came to us for advice as they realised that any action taken by HMRC would likely lead to bankruptcy proceedings against them as there was no corporate veil protecting their personal estates from the liabilities of the partnership. Under the Partnerships Order 2004 and the Enterprise Act 2002, it is possible to place a partnership into administration to protect its business from action by creditors. However, its downside is that this could not protect the individual partners from bankruptcy and unless the business could be sold for sufficient sums to create solvency, the partners would be liable for any creditor shortfall. Unlike its corporate counterpart, administration wasn't going to be "all-singing, all-dancing" solution that it could have been.

Therefore we considered a partnership voluntary arrangement ("PVA"). These are similar to CVAs except for the fact that it is essential to determine the interaction between the partner's personal estates with the partnership estate, and must be interlocking with personal IVAs whereby the individual estates show that the partners are insolvent themselves. Because HMRC were a material creditor, it was known from the outset that the success of the PVA was going to be determined by the decision of the Voluntary Arrangement Section of HMRC.

PVAs are very rare and would be almost impossible where a partnership had a number of partners. This case had only 4 partners so we were confident that proposals could be constructed but we had no idea how they would be perceived by HMRC.

Looking at the numbers, 3 out of 4 of the partners were insolvent if you took into account the amounts owing to the partnership. Two estates would still be insolvent excluding any amounts owing to the partnership on their current accounts. The first draft of the PVA provided for a payment of 50p in the pound.

HMRC suggested that this would be in keeping with their requirements but made two very pertinent points. Firstly they required that if any partners had unsecured creditors, that they entered into simultaneous interlocking IVAs. They also wanted to ensure that the partners' personal income and expenditure was critically assessed to explore whether salaries paid from the partnership were at the correct level to ensure that only minimum amounts were paid out the partnership, thus increasing contributions to the arrangement. The amount of detail into the joint income and expenditure of each of the partners' household was far higher than I would have expected, especially given the number of CVAs (and the occasional PVAs) that HMRC must handle each week. I think the fact that this was a PVA made it stand out and receive particular attention. After several weeks of negotiation, HMRC had restricted partners' drawings from the partnership to cover the minimum household expenditure for each partners' personal needs.

HMRC also looked at partners putting their houses up for sale to reduce mortgage costs, but after further enquiry, the rental would have been just as high, so this was not required. The fact that HMRC would have required this, shows just how far they would go! Although there were a number of other complications involving bank security over personal assets, we finally agreed a PVA at 65 pence in the pound and an IVA for one partner, the other insolvent partner having a third party pay off his unsecured debt.

Although obtaining the agreement of the PVA is a great success, and has not only enabled the survival of the partnership (with its employees), and the partners' ability to earn a living, it also enables HMRC to collect c£3m in tax over the period of the PVA. I believe that the increase from 50 pence to 65 pence will be challenging and only time will tell whether HMRC's insistence to squeeze every last penny out of the partners was a sensible strategy.

This is a fairly sorry tale, as it seems to me that the partners, unlike directors of a company, have to wash all their dirty linen in public and are then hung out to dry. Whilst PVAs remain a rare, but achievable solution, it highlights the need to avoid partnerships as a mechanism for business, as the personal liability and complex nature of their formation makes their survival that much harder.

Time to Pay or Not to Pay – That is the Question

Given the earlier article – In Partnership with HMRC….. I thought we should consider HMRC's recent change in attitude towards *Time to Pay* arrangements.

To set the scene, HMRC lost their preferential status in September 2003 when the Enterprise Act 2002 came into force. This relegated all HMRC claims to unsecured status leaving only employees and outstanding contributions to Company Pension Schemes as preferential creditors. Over time, this has changed the ethos at HMRC who have had to become more proactive in pursuing debts. This has resulted in many more threats to wind-up and the occasional use of distraint over company property.

Although crown debts should never be used by directors to fund continued trading, it was clear to HMRC that they were often last to be paid and action by HMRC sent out a firm message "Pay or suffer the consequences!"

It is thought that around 300,000 businesses have deferred tax payments of over £5.2billion under the *Time to Pay* scheme. It is inevitable that some of these businesses will succumb to formal insolvent procedures when these *Time to Pay* arrangements cannot be met and they are forced to pay their remaining tax liabilities.

However, with the severe downturn in 2007, HMRC, being a government body, could not be seen to be bringing UK business to its knees. As a result (although apparently denied now) *Time to Pay* schemes were introduced to allow businesses breathing space to get through tough times.

It appears that HMRC are adopting a more aggressive approach over recent months. A prime example is the number of football clubs which have fallen into Administration as a result of petitions being served by HMRC. We must remember that HMRC are a tax collection agency and have no reason to assist businesses in paying liabilities to the Crown. They have confirmed that their internal systems are improving with regard to debt collection and that businesses that are in default of their tax obligations will increasingly see HMRC being more aggressive in pursuing debt.

My concern is that an increasing number of businesses will fall foul of their *Time to Pay* arrangements leading HMRC to take action against them. In my opinion, in light of HMRC's more aggressive approach they will take a dim view of companies being unable to pay and force more businesses into liquidation. I think this is likely to materialise in an upturn in insolvencies in the latter part of 2011 and throughout 2012.

So what does the New Year bring?

Ian Robert's predictions for 2011:

- Unemployment to continue to rise throughout the whole year
- Interest rates to rise from 3rd quarter
- Retail fallout after 1st quarter
- Simon Cowell to split from fiancée

Wishing all our contacts a merry Christmas and a prosperous New Year!

Contact Us

Ian Robert (0)20 7566 3672
irobert@kingstonsmith.co.uk

Nick Miller (0)20 7566 4020
nmiller@kingstonsmith.co.uk

Ian Defty (0)1727 896072
idefty@kingstonsmith.co.uk

Mike Solomons (0)1727 896072
msolomons@kingstonsmith.co.uk

Devonshire House, 60 Goswell Road
London EC1M 7AD T: + 44 (0)20 7566 4020

105 St Peter's Street, St Albans,
Herts AL1 3EJ T: + 44 (0)1727 896015

W: www.kingstonsmith.co.uk/corporaterecovery